

GOAL TWO: MAXIMIZE TAXPAYER VALUE

Maximizing taxpayer value is the second goal outlined in Ex-Im Bank's FY99 Annual Performance Plan. Ex-Im Bank **maximizes taxpayer value** by steadily leveraging the government resources devoted to supporting needy exports. As a government agency that receives a budget appropriation from Congress, Ex-Im Bank also places a high priority on using the resources Congress has appropriated to achieve its mission effectively and efficiently. In its Annual Performance Plan, Ex-Im Bank identified two objectives inherent to achieving this goal: 1) reducing the breadth and depth of non-market influences in foreign, officially supported competition; and 2) developing innovative approaches to asset management that reduce Ex-Im Bank portfolio risk. Since the development of the APP, Ex-Im Bank has begun to pursue a third objective -- expanding the risk sharing capacity of the private sector.

Objective One: Reduce the breadth and depth of non-market influences in foreign, officially supported competition.

Fees/ECA Issues

○ Results

In the middle of 1999, the new OECD Fee Agreement went into affect. This new agreement is one of the final steps in removing subsidies from export credit agencies financing packages. Specifically, there will be little room in the future for differences in the pricing of one ECA's financing package from another ECA's financing package because under the agreement, minimum exposure fees are set for sovereign and country credit risks.

○ Lessons Learned

Over the years, the key factors in evaluating Ex-Im Bank's overall competitiveness vis-à-vis its G-7 counterparts have typically been related to aspects that affect the "cost" of financing, such as interest rates, risk fees and tied aid. However, given the recent financial turmoil in most major ECA markets (which has suppressed demand and considerably narrowed non-ECA financing options) there is some question as to whether or not competition on the basis of marginally more or less expensive ECA financing packages is typically the critical factor in determining winners and losers in today's export sales. Rather, it appears that the key determinant of ECA competitiveness has become cover (or risk taking) policy. This term refers to an ECA's willingness to provide support for risky markets, and the conditions under which the support for any particular market is given.

The fact that the competitiveness touchstone is shifting from relative financing costs to relative willingness to provide support in challenging markets plays to Ex-Im Bank's strengths. Ex-Im Bank is more competitive in supporting exports

to challenging markets because it generally has fewer restrictions on its cover policy than other ECAs.

When Ex-Im Bank attempted to determine the proximity of ECA fees to market levels through a comparison of market benchmarks for the “all in” cost of standard ECA offers, a gap in the current data collection procedures of the OECD was exposed. Currently, the OECD neither publishes nor collects the data that would be necessary to begin to generate this sort of study. As the OECD does not have the underlying data necessary, Ex-Im Bank cannot at this point accurately determine the proximity of ECA fees to market levels, although Ex-Im Bank believes that the new fee agreement has brought all ECA fees closer to market level. As of the date of this report, the premia experts of the OECD have presented a paper stipulating exactly what data needs to be captured so that going forward, the OECD would be amassing the data necessary to generate this type of a comparison.

In summary, findings from Ex-Im Bank’s annual competitiveness report indicate there is a transition from an era mainly characterized by ECA competition on the basis of financing costs to a new one, in which ECAs’ willingness to provide support for risky markets and unusual structures appears to be the main determinant of “competitiveness.”

Project Finance

○ Initiatives

In FY99, two major changes were introduced to Ex-Im Bank’s project finance program. First, Ex-Im Bank began to offer comprehensive coverage during project construction, instead of just political risk coverage. Second, the new OECD repayment flexibilities for repayment terms could be introduced into potential projects. The flexibilities are rules implemented on September 1, 1998, for project finance transactions for participants to the *OECD Arrangement*. These new rules allow Ex-Im Bank to provide more flexible loan repayment terms to match a project’s revenue stream. Thus, project finance transactions can be structured with tailored repayment profiles, more flexible grace periods, and more flexibility on total repayment terms. These two factors combined have enhanced Ex-Im Bank’s ability to compete with other ECAs and respond directly to the needs of US exporters competing to supply major projects overseas.

○ Results

In FY99, Ex-Im Bank’s Project Finance Division approved one deal in Mexico for \$180 million. Within the parameters of this transaction, Ex-Im Bank did not

need to use the new project finance flexibilities allowed under the *OECD Arrangement*. As such, the extent to which tailoring the repayment schedule of the project to the project's cash flow has improved the creditworthiness of the project cannot be determined.

Although the recent financial crisis has put many large projects on hold, Ex-Im Bank actively reviewed nine cases in its FY99 portfolio. This figure, an increase in the number of active cases in FY98, is due in part to Ex-Im Bank's newly strengthened competitiveness. This figure also reflects a partial rebound in world markets after the Asian crisis; while the markets now show a willingness to entertain project proposals, the bond markets are not yet deep enough to finance these projects. Project sponsors also believe having an official ECA as a lender produces more comfort through its "halo effect". The halo effect is defined as the protection lenders involved in a project finance deal receive as a result of Ex-Im Bank's participation in the deal; essentially, since no party to a deal wants to default to the US Government, any other lender participating in the project theoretically is insulated from defaults as well. Therefore, Ex-Im Bank is again playing a valuable role in filling in private sector financing gaps. While only one deal closed before the end of FY99, six others remain active and can be expected to close in FY00; the remaining two deals were deferred. Ex-Im Bank is expected to approve several Turkish gas-fired power plants in FY00, and is considering transactions for power projects in Asia. Ex-Im Bank is examining a gas-fired project in the Philippines that is worth approximately \$200 million, and is in the early stages of negotiation on projects in Thailand and China. Project finance in Asia is important to U.S. exporters and is instrumental in supporting Asian recovery. However, Ex-Im Bank must resolve some difficult questions relating to existing independent power project commitments in Indonesia, Pakistan and other Asian countries.

Multilateral Environmental Guidelines

- Initiatives

Ex-Im Bank has a two-pronged approach to enhancing its support for environmental exports. The first is creating financial programs that make it attractive to export environmentally beneficial technology and the second is the establishment of environmental guidelines for all projects Ex-Im Bank supports. Ex-Im Bank's environmental guidelines have resulted in increased environmental sales. But, despite these increased sales, there is always a chance that a US exporter could be put at a competitive disadvantage due to the incremental costs associated with environmental equipment because Ex-Im Bank is the only export credit agency with environmental guidelines. For this reason, Ex-Im Bank has been working within the OECD to establish a multilateral system of environmental guidelines. This work has not been easy since none of the other ECAs have any historical experience with environmental issues.

- Results

In 1999 Ex-Im Bank took two steps forward in establishing multilateral environmental guidelines. First, the G8 Cologne Summit Communiqué called for ECAs to work toward “environmental guidelines” and the other ECAs began to take modest unilateral actions to help identify the environmental concerns that specific projects raised. Second, ECAs agreed to exchange environmental information on specific projects.

Objective Two: Develop innovative approaches to asset management that reduce Ex-Im Bank portfolio risk.

Initiatives

During FY1999 Ex-Im Bank had a small number of large credits that were impaired. Most of these credits are in Asia, and the financial difficulties in these credits result largely from the recent Asian financial crisis. While Ex-Im Bank may incur some losses on these credits, Ex-Im Bank has been diligent in seeking recovery and participating in restructuring efforts.

A significant portion of Ex-Im Bank’s restructuring activities in 1999 was related to a project in Indonesia (Paiton Energy), the viability of which has been threatened by Indonesian economic conditions. Ex-Im Bank has extended the lender’s availability period to request Ex-Im Bank to subrogate its debt, known as the “take out period”, for Paiton to December 2000, to allow additional time for the project to demonstrate its financial viability and economic sustainability. The Asset Management staff has just begun discussions on restructuring this project.

Over the course of 1999, Ex-Im Bank, under the framework of the Paris Club of creditor countries, successfully negotiated and entered-into-force new bilateral agreements and new debt consolidation stages with Honduras, Uganda, Senegal, Nicaragua, Niger and Cameroon. The implemented new bilateral agreements and new stages of debt consolidation provided the underlying debtor countries with debt relief in the form of debt forgiveness (\$10 million) and debt rescheduling (\$6.5 million) for payments already past due.

Results

At the end of FY99, Ex-Im Bank’s loss reserves totaled approximately \$10.2 billion, a 7.2% increase over total loss reserves of \$9.5 billion in FY98. Total loss reserves represented 18% of the Bank’s total exposure of \$58.4 billion as opposed to 17% of total exposure of \$55 billion in FY98.

The increase in loss reserves was the combined result of the exposure increase of \$3.2 billion in the portfolio and the risk rating changes of both sovereign and non-sovereign obligors implemented during the year. In the sovereign sector, the

downgradings of several key markets resulted in a net loss reserve increase of \$344 million. In the non-sovereign sector, there were significant downgradings of several project finance cases in Indonesia and Pakistan, which required additional loss reserve provisions. On a more positive note, the upgrading of several Korean companies helped to offset some of the loss reserves increases resulting from the downgradings. The upgradings in Korea were in response to the significant turnaround of the economy in the country after the 1998 financial crisis.

The ratio of loss reserves to loan and claim receivables, excluding capitalized interest, decreased to 32% in FY99 from 33% in FY98. Also declining was the ratio of loss reserves to contingent liabilities (also known as off-balance sheet items) from 16.4% to 16.3%. The decline of both ratios occurred because of the proportional and correlative effects that the new loss percentages and increase of the portfolio exposure had in loss reserves. The loss reserves increase of \$692 million, and net loan-writeoffs and closed claims of \$16 million comprised the provision of \$707 million charged to income for the fiscal year. In FY98, the provision was \$2.5 billion.

As of the end of FY99, Ex-Im Bank's portfolio of loan, guarantee, medium term insurance and claim transactions stood at nearly \$60 billion, an increase of \$3.2 billion (6%) from FY98. The combined exposure of the 10 largest exposure countries accounts for 53% of Ex-Im Bank's portfolio while the combined exposure of the 10 largest exposure obligors accounts for 25% of the portfolio. At fiscal year end, Ex-Im Bank's portfolio was less risk-concentrated both on a per-country and per-obligor basis than it was at the end of FY98 when the 10 largest exposure countries and the 10 largest exposure obligors accounted for 57% and 28%, respectively, of the portfolio. However, the weighted average budget cost level of Ex-Im Bank's portfolio was slightly more risky than at September 30, 1998, due to the correlative increase of the portfolio's exposure and number of risk changes (mostly downgradings) implemented during the fiscal year.

Objective Three: Expand Risk Sharing with the Private Sector.

Initiatives

On February 16, 2000, Ex-Im Bank announced an invitation to submit proposals (ISP), which invited the private sector to submit proposals for private institutions to share in Ex-Im Bank's portfolio and risk. Ex-Im Bank staff had been exploring this idea internally over the past two years and spent much of 1999 considering various risk sharing proposals and developing an approach for equitably selecting the best facility. This innovative proposal challenges the market to structure a facility that involves meaningful risk participation by the private sector and is cost effective for Ex-Im Bank. Ex-Im Bank expects this approach will prove to be a significant means to leverage resources – to increase the return for the taxpayer.

